

**FINANCIAL SERVICES AND MICROENTERPRISES IN SOUTH
AFRICA: STATUS, PROBLEMS AND POTENTIAL**

by

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Financial Services and Small and Microenterprises in South Africa: Status, Problems and Potential

by

Marielle Zeidler

I. Introduction

The author worked for three months with the Task Group on Small Enterprise Development formed in December 1992 by the Democratic Movement of South Africa and the Friedrich Ebert Stiftung. The group identified the promotion of small and microenterprises as a priority area for the future democratic South Africa in order to cope with the economic problems the country is facing and support black economic empowerment. The group's mandate is to draft policy guidelines for small and microenterprise promotion to support the new government's policies towards those firms. The author addressed issues concerning the role of financial services for small and microenterprises with a focus on non-metropolitan areas.

The objective was to identify possibilities for the promotion of small and microenterprises through improved access to financial services. This objective was to answer two questions:

- Is the lack of access to financial services (mainly loans) a constraint or the principal constraint for small and microenterprise development in South Africa? If yes, then,
- Are the financial services currently offered matching the needs of South Africa's small- and microenterprises?

A small survey was conducted in two non-metropolitan regions of South Africa, and existing data and surveys were evaluated. The findings are outlined in this paper.

In the **first section** of the paper, the current role of black small and microenterprises in South Africa will be addressed and their expected role in the future discussed. Two main determinants of the structure of the small and microenterprise sector will be investigated. The restrictions of apartheid, and its legislation and the economic environment in which enterprises are embedded have serious impacts on the sector. Therefore, the landscape of small and microenterprises differs substantially from other countries.

The second and third section will be based on surveys. Data were collected via open interviews and closed questionnaires. Interviews were conducted with small and microenterprises as well as with institutions providing financial services to this type of enterprise. Due to the limitations (in regional as well as in numerical terms) of the small sample, other accessible studies

were incorporated. However the data base concerning the small and microenterprise sector is very limited and data collection started flourishing only during recent years.

The **second section** will highlight common characteristics of small and microenterprises in South Africa and describe the restrictions and constraints faced by those firms in their operations. Financial, technical, training, legal and overall economic issues will be addressed. This section will particularly look at financial services demanded by small and microenterprises.

The limited access to appropriate financial products was identified as a more or less significant obstacle for the development of small and microenterprises from the demand side. To complete the picture, the supply side of those services was examined and presented in **section three**. The major actors and their financial products, services and programs will be highlighted. Formal, semi-formal and informal financial arrangements will be considered and attention given to certain key variables. Problems and constraints faced by the suppliers of financial services to small and microenterprises will be discussed.

Section four will attempt to draw conclusions and recommendations for the development of small and microenterprises through financial services in South Africa. It will argue for a holistic financial system approach and does not regard the provision of financial services or loans through specialized programs as an appropriate instrument to overcome the inequalities created by apartheid. It is concluded that neither the market approach nor the program approach can deal with redistributive objectives.

II. The Country Context

A. Background Data¹

The worldwide unique situation of South Africa created by forty years of strict politics based on the ideology of apartheid is reflected in the country's indicators. The "first world/third world" division of South Africa is especially apparent in the structure of the economy. Relevant key indicators important for the purpose of this paper will be highlighted.

¹ Development Bank of Southern Africa, South Africa: An inter-regional Profile, Center for Information Analysis (Midrand, Development Bank of Southern Africa, 1991), 10; World Bank, "World Development Indicators," World Development Report 1993: Investing in Health (New York: Oxford University Press, 1993), 239-263; Development Bank of Southern Africa, Labour and Employment in South Africa: A regional Profile 1980-1990, comp. D. J. Viljoen (Midrand, Development Bank of Southern Africa, 1991), 24-25; Republic of Southern Africa, Bulletin of Statistics Quarter ended June 1993, Vol. 27 No. 2, Section 12 (Pretoria, Central Statistical Service, 1993); The New York Times, "Foreign Exchange", New York Times, 31 December 1993, p. F 12; Statistisches Bundesamt, "Länderbericht Südafrika 1991" (Wiesbaden, J.B. Metzler/C.E.Poeschel, 1991).

Table 1: South Africa in Figures.

Indicator	1989	Indicator	1989
Population	37,080,000	Absorption capacity ^a	50.4%
Annual growth in population	2.85 %	Unemployment rate ^b (1991)	14.9 %
Exchange rate	US\$1=3.34 Rand	Potential labor force	15,904,000
Functional urbanization rate	65 %	Annual growth in GGP ^c (1992)	-2.3 %
Interest rate ^d	21 %	Nominal GGP per capita	5,581
Deposit rate	17.3 %	Inflation rate ^e	14

- a: The percentage of the potential labor force employed in the formal sector of the economy.
b: Unofficial estimates range from 40 to 60 percent.
c: The Development Bank of Southern Africa uses Gross Geographical Product (GGP) to indicated that homelands are included.
d: Prime overdraft rate (1991).
e: Average annual rate (1980 to 1991).

B. Definition of Small and Microenterprises

South Africa is still in the process of developing country-specific definitions of enterprise categories. The dilemma of combining the highly capitalized computer consultant and the typical street hawker in one group solely because of their similarity of being be a one-man show is well known. An acceptable compromise between quantitative and qualitative criteria must be found.² Minimizing costs and maximizing benefits should be the dominant motive. In controversial discussions in recent years, it has become evident that the generally accepted subdivision into four types --big, medium, small and microenterprises-- also exists in South Africa. Only the case of non-farm enterprise activities will be considered.

Most recent surveys and documents dealing with the small and microenterprise sectors are consistent with the guidelines formulated by USAID which originated in their pioneering work of stock taking of microenterprise programs. This paper will also use this definition. An enterprise with 10 to 50 workers is considered small and one with less than 10 people is micro. In addition the following qualitative characteristics can be taken into account by distinguishing if firms belong more to the small than to the micro enterprise category.³

² A detailed discussion can be found in Malcolm Harper, "What are Small Enterprises", Businesses in the Third World: Guidelines for Practical Assistance, (Chichester, Intermediate Technology Publications Ltd., John Wiley & Sons, 1984), pp. 1,2.

³ James Boomgard et al., "Taking Stock of A.I.D's Microenterprise Portfolio: Background and Conceptual Overview", Evaluation and Occasional Papers, Draft (Washington, U.S. Agency for International Development, 1989), pp. 14-16.

Table 2: Distinguishing Characteristics of Small and Microenterprises.

	Microenterprise	Small enterprise
Workforce	The workforce is comprised primarily of family labor.	Hired workers comprise a significant share of the total workforce.
Sources of Finance	Rely mainly on cash transactions, informal credit markets. Start-up commonly funded by own or family savings.	Limited access to formal financial markets; commonly rely on informal financial markets and retained earnings.
Management	Little management specialization.	Some specialization in management functions.
Technology	Traditional - based on widely existing technical knowledge, existing labor skills and existing raw materials supply; less access to new technologies.	Less traditional: innovation required in some aspect of the transformation process; better access to new technologies.
Products	Products and services are generally simple and unsophisticated; prices are low, cater to 'basic needs' of low-income consumers;	Products and services range from simple to more complex; span a relatively broad range of consumer types.
Markets	Typically serves highly localized markets through simple marketing channels.	Marketing patterns somewhat more complex reflecting innovation in raw material procurement or in output sales.
Competition	Competition intense as a result of ease of entry and localized market area.	Competition somewhat less intense due to greater barriers of entry.
Earnings	Returns to owners generally very low.	Returns higher but subject to greater variation and risk.

In addition it is useful to subdivide the microenterprise sector. Dessing⁴ suggests distinguishing between three levels. At the current stage, a subdivision into survival and non-survival oriented microenterprises seems sufficient for South Africa, because of the relative short existence of the sector due to the strict enforcement of regulations until the seventies. Survival orientated activities are marginal and motivated by the drive to earn income for the minimum of living necessities rather than by the urge to prosper. Those operations are insufficient to allow human and financial accumulation of resources.⁵ Major changes have not occurred in a short time span. For purposes of policy making, this distinction is important. Policies in support of survivalist microenterprises focus on poverty alleviation rather than private sector development.

Another consideration is whether a reduction from 10 to 5 workers in order to qualify as a microenterprise would make more sense for South Africa especially in the black small and microenterprise markets. It was found, however, that 97 percent of all microenterprises employ 5

⁴ Maryke Dessing "Support for Microenterprises: Lessons for Sub-Saharan Africa", World Bank Technical Paper No. 12 (Washington D.C., World Bank, 1990), pp. 18-19.

⁵ James Boomgard, "Taking Stock of A.I.D's Microenterprise Portfolio", pp. 16-18.

or less workers. A distinction between enterprises operating in the formal or informal sector seems irrelevant.⁶

C. Current and Future Role of Black Small and Microenterprises

The role of black small and microenterprises is equivalent to the total role that black enterprises play in the country simply because large and medium enterprises hardly exist. As recently as 1991, only three companies listed on the Johannesburg Stock Exchange were owned by blacks. As business owners in the formal sector, blacks are still insignificant. Estimates from 1990 suggested that only 4 percent of the businesses in South Africa outside the 'independent' homelands were owned by blacks. These were very small in comparison to white-owned businesses.⁷

The only place where black South Africans dominate is the informal marketplace. The long years of stagnation and contraction of the South African economy have forced the black population group into self-employment. Half of all economically active blacks are thought to be working in the informal sector. Estimates of the informal sector's contribution to GDP range between 6.5 and 41 percent, but a figure of 12 percent is considered to be the most realistic. Approximately three million black South Africans work in this sector, and another 1-3 million South Africans are estimated to have no work at all. Black businesses are operating in the form of a typical microenterprise; most of them are survival orientated. Poverty is therefore endemic in the country, especially in rural areas and in informal urban settlements. In 1990, of the 17 million people living in poverty, 16 million were black. Approximately 11 million were living in rural areas.⁸

The black participation in salaried employment compared to whites has increased and in turn the share in purchasing power increased to over 50 percent in the country.⁹ Black enterprises stepped in and took advantage absorbing the increase in black purchasing power and minimizing the return to the white enterprises, where they are excluded and rarely had a chance to accumulate wealth. For

⁶ Because this paper draws data from different sources with heterogeneous definitions, a clear distinction is not always possible. Only where big discrepancies arise, will it be noted. Otherwise, the above definition applies.

⁷ U.S. Agency for International Development (U.S.AID)/South Africa, "Strategy Concept Paper", Fifth Draft (Pretoria, 1993), pp. 19-22.

⁸ Marié Kirsten and Makgoshi Sindane, "The Informal Sector and Small Business Development", Draft (Midrand, Development Bank of Southern Africa, 1991), pp. 3-4.; Stanley Matsebula, "Adapting South Africa's Financial Markets to cope proactively with Development Funding" Paper delivered at a Local Financial Market Conference, 26th & 27th January 1993, Volkswagen Conference Center, (Midrand, 1993), p. 4.

⁹ Whereas the growth rate in employment between 1979 and 1989 was 40.8 percent, for whites it was 31.3 percent., Statistischen Bundesamt, "Länderbericht Südafrika 1991", p. 56.

example, between 1978 and 1991, the proportion of purchases made by Sowetans outside Soweto declined from an estimated 90 percent to 50 percent.¹⁰

The stagnating economy is not able to absorb the steadily increasing labor force in formal employment. In absolute terms the numbers of formally employed people has decreased. Even if the economy can be revitalized in a post-apartheid South Africa, an optimistic estimation of a 5 percent increase could generate only about 150,000 jobs whereas the workforce is growing by more than 400,000 persons per year.¹¹ Given that the labor force is increasing by 2.8 percent a year, the formal economy would have to grow by 7 percent a year simply to create jobs for the new labor market entrants.¹² The rest must either look for employment opportunities in the informal sector or step into entrepreneurship.

This scenario makes it quite obvious that South Africa's economic crisis is deeply entrenched and structural in nature. While a new political order in the form of a non-racial democracy may be imminent, this may be meaningless unless accompanied by a regeneration and restructuring of the economy.¹³ It can be easily argued that black economic empowerment is the single most important long-term concern facing South Africa in its attempt to ameliorate legacies of apartheid. If economic stagnation cannot be tackled simultaneously, the difficult dilemma of redistribution of wealth arises.

The contribution of the small and microenterprise sector is therefore seen as an engine of growth and change toward black economic empowerment. It receives a high priority for intermediate economic restructuring from all potential new political parties. Fulfilling this role is thought to be feasible, and the Development Bank of Southern Africa estimates that small and microenterprises could constitute between 50 and 55 percent of domestic economic activity by the year 2000.¹⁴

¹⁰ U.S. Agency for International Development (U.S.AID)/South Africa, "Strategy Concept Paper", Fifth Draft, (Pretoria, 1993), pp. 19-22.

¹¹ Jerry B. Eckert, "Key Roles for Small Businesses in South Africa's Economic Restructuring", Paper presented to Sowetan/DBSA Conference on Business and Entrepreneurial Development (Midrand, DBSA, 1992), 2; Development Bank of Southern Africa, Labour and Employment, pp. 20-27.

¹² Development Bank of Southern Africa, South Africa: An inter-regional profile, p. 29.

¹³ Sharda Naidoo and Norbert Eichler, "The Definition and Role of Small Enterprises" (Johannesburg, Friedrich Ebert Stiftung, 1993), p. 6.

¹⁴ Jerry Eckert, "Key Roles for Small Businesses", p. 2.

The expected role of small and microenterprises can be summarized as follows:¹⁵

- Creation of employment
- Reduction of poverty
- Democratization of the economy

These high expectations are subject to controversial discussions as is the degree of support for small and microenterprises. It is undisputed that this sector should be an area of priority for any future government. A consensus as to what extent this sector is able to do the job of balancing the inequalities of apartheid is far from being found. The advantaged segments of the population and big firms are overwhelmingly supportive of a comprehensive small and microenterprise strategy. They hope that they can minimize the painful divesting of the well-loved gains attained through long years of privileges and protection. But it is quite clear that a redistribution cannot be achieved solely by the promotion of this sector alone. A removal of policies biased toward big, urban and white businesses must simultaneously take place. The clear policy of industrial protection and the heavy subsidization of the agriculture sector with a detailed and complex set of tariff rates tailored to the need of each industry adversely affect small and microenterprises.¹⁶ Removal of these policy instruments would be far more effective than each mini loan program initiated by a new government in favor of the small and microenterprise sector.

A primary concern must still be the expansion of the formal economy to provide employment opportunities. The survey undertaken by the author clearly indicates that South African people overwhelmingly prefer to be formally employed rather than work as entrepreneurs facing uncertainty and risk. Characteristics of self employment like independence, creativity, and challenge are not everyone's business.

D. Determinants of the Business Structure

Besides others, two determinants have mainly influenced the current structure of the black small and microenterprise sector: the regulatory framework based on the apartheid ideology, and the recessionary period the country has experienced during the last ten years. These factors produced the structural characteristics of the black business sector and are the key variables for any future policy strategy in determining the role this sector might play in achieving a reduction in income, wealth, and employment differentials between blacks and whites in a stable, growing post-apartheid South Africa. While the apartheid legislation is responsible for the black business sector's small size

¹⁵ Taskgroup on Small Enterprise Development (TASKGRO), "Policy Proposals for Small, Medium and Micro Enterprise Development", Discussion Paper (Johannesburg, Friedrich Ebert Stiftung, November 1993), pp. 7

¹⁶ Stephen R. Lewis, "The Experience of Primary Exporting Countries," in Handbook of Development Economics, Vol. II (Amsterdam, 1988), p. 1588.

and restrictiveness in scope, the overall economic situation has pushed many blacks into new survival orientated microenterprise undertakings.

a. Legislation

Any review of the history and evolution of the black South African business sector becomes invariably a study of the politics of apartheid and its origins, objectives and consequences.¹⁷ In few countries do political considerations affect economic decisions in such a stark fashion. A small white minority oppressed the majority of the non-white South African population to control the country economically and politically and manifest their superior status in terms of a higher living standard reflected in one of the highest Gini coefficients of income distribution in the world. A complex web of implicit and explicit regulations denies opportunities to black entrepreneurs.¹⁸ The restrictions imposed on the formation of black enterprises determine their existence, their potential to grow and their inclusion into the formal sophisticated South African economy.

The general hostile and restrictive attitude toward black businesses started even before 1948 when the apartheid regime under Verwoerd came into power. Early emergence of urban black entrepreneurs can be seen as attempts to keep the urban areas in the hands of the whites. The black presence in these economically promising areas was only tolerated in so far as they provided cheap, unskilled labor for the prospering white industry and commerce. This temporary status of black residents in urban areas is at the root of legal restrictions placed on the formation and growth of black businesses. The legal reflection of this discouragement can be found in the Native Land Act of 1913 which prohibited blacks from buying land outside of the native areas created by whites. This exclusion of blacks from the system of enforceable property rights in urban areas, smothered the emergence of black enterprises by making it even more difficult to access the formal financial markets. The cornerstone of restrictive legislation toward the development of a strong legal black enterprise sector was created by this law.¹⁹

The interim status of blacks in white cities was enforced through an apparatus of strict controls resulting in the Influx Control Act. This restricted the right of blacks to move freely in the country, thereby preventing the feared acceleration of rural-urban migration and prevented white

¹⁷ See for further discussion, U.S.AID, "History and Evolution of Black Business", in Black South African Private Sector: In- depth Analysis of the History, Evolution, Constraints and Opportunities, vol. 2, (Johannesburg, Consumer Behaviour Pty Ltd., 1987), pp. 1-46.

¹⁸ Nicoli Natrass, "The Small Black Retail Sector in South Africa," World Bank, 1992, p.17.

¹⁹ Carl Liedholm and Thyra Riley, "Characteristics of and Constraints Facing Black Businesses in South Africa: Survey Result"(Draft for Comment prepared for Small And Medium Business Enterprise Seminars), in The Development of Small and Medium Business Enterprises in Economically Disadvantaged Sections of South African Communities, Conference hosted by Kagiso Trust and World Bank (Cape Town, Durban, Johannesburg, 1993), pp. 5-7.

businesses from any potential competition from their black counterparts. White authorities controlled the allocation of formal business sites in urban black townships linked to requirements of literacy, own equity contribution, etc. The Native (Urban Area) Act No. 21 of 1923 and the numerous amendments resulting in the consolidated Native (Urban Areas) Act 1945 determined the location as well as the kind of enterprises which blacks were allowed to operate in those areas. Trading in non-homeland areas was restricted to the daily essentials of living like milk, bread, or vegetables. Besides those bare necessities of living, the more lucrative entrepreneurial activities such as bookshops, pharmacies, garages, and hairdressing remained strictly reserved for whites only.²⁰

The regulations restricting black enterprises became even more restrictive under the Verwoerd regime beginning in 1948. The Group Areas Act forced the few black enterprises and the more numerous Indian enterprises that had managed to obtain a business site in urban areas to either close their operations or relocate them into the township or homeland areas. The regime, extremely responsive to pleas of the white business sector for protection from competition, resulted in a white paper circulated in 1963 among the township authorities known as the 'one man-one business' paper. The black enterprise sector was restricted in terms of location and scope (25 activities were allowed; in 1975 this number increased to 52), and this paper further robbed the blacks of their chance to expand their businesses through economies of scale. Blacks were not allowed to form companies and partnerships to initiate larger ventures. In addition the laws in 1963 blocked the creation of black-controlled financial institutions, manufacturing industries and wholesale businesses. The erection of business buildings was the responsibility of the local authorities, who also issued the licenses for blacks to operate formally in the permitted trades.²¹

Besides the national legislation, numerous other regulations restricted black entrepreneurship at the regional and municipal level. In general, the policies were aimed at ensuring the reflux of wages earned by black workers into the white economy to prevent black investment and wealth accumulation, which would empower them economically and hence politically.

The second round of apartheid legislation, the Bantustan Education and the Job Reservation Policies, determined the structure of the black enterprise sector and its future potential. The inferior education that the majority of blacks received was aimed at producing a pool of employees to serve the needs of the white economic sector. Apprenticeships in most technical skills were reserved for the white youth. Job reservation laws excluded blacks from certain professions (mainly those requiring extended responsibilities, decision making and managerial capacities). The development of entrepreneurial potential and spirit was extinguished right from childhood in the life of black person.

²⁰ Ibid, pp. 5-6.

²¹ Ibid., page 6.

The limited base of available skills restricts the expansion of the share of manufacturing enterprises and subcontracting possibilities between small firms and bigger companies.²²

The black business sector in the different homelands cannot be described here in detail. Restrictions faced by the enterprises in these areas were dependent on the individual government of the more or less independent homeland government. Whereas some of them have harsh and restrictive policies toward small and microenterprises, others are more liberal even promoting them through training, access to finance, and subsidized inputs, which in turn raises other problematic issues like targeting assistance to firms within the sector. Generally the potential for small and microenterprises in those areas was limited. Most of the economically active population was forced to migrate and work for white companies in South Africa. Therefore, the remaining population of the homelands was old people and the children of urban migrants. The migrant labor system destroyed the social structure of the population so that even the potential for enterprises operating with traditional methods was limited. The integration of the homeland in the post apartheid South Africa will place other obstacles for the development of the small and microenterprise sector.

Most of the explicit restrictions imposed on the black enterprise sector were removed in a deregulation period declared by the South African government beginning in the eighties.²³ The pillars of apartheid indirectly influencing entrepreneurial freedom tumbled after 1986. The official policy toward black enterprises was transformed into one of acceptance, encouragement and upgrading of small black enterprises. This new approach was accompanied by a broader economic policies in favor of markets and away from excessive state economic regulation.

Despite the recent moves, one should be aware that there are still many laws in existence hampering the development of small enterprises; these include advertising laws, animal slaughtering/meat processing, hawking/vending laws, home business regulations, rural trading restrictions, licensing laws, etc. Legal restrictions were mainly seen as equivalent to the confiscation of goods, forced removals, etc.

While legal discrimination *de jure* has been abolished and the remaining laws can be easily removed by the stroke of the pen, *de facto* discrimination remains a daily business practice, creating restraints to operations and high transaction costs. The needed legal concept of 'there shall be no legal discrimination' and 'discrimination is illegal' must be addressed. Without the latter concept

²² Nicoli Natrass, "The Small Black Retail Sector in South Africa" (World Bank, 1992), pp. 18-22.

²³ For different periods of the regulatory framework of the black business sector, see Pinky Mashingo and Claudia Manning "Environment Governing South African Microenterprises", *Informal Manufacturing in South Africa* (1992), pp. 54.

universally in place and institutionally enforceable, smaller businesses, mostly operated by non-whites, have no recourse to battle subtle discrimination in their business environment.²⁴

Bantustan education and job reservation policies have created damages which seem to be only removable in the medium and long term, but there is still room for more short-term effective deregulation and proactive support.

b. Performance of the overall economy

While legislative issues restricted the formation and growth of the black business sector, the adverse economic situation of the formal economy did the opposite. It contributed to a mushrooming of black microenterprises mainly operating in the informal sector.

Economic activity and output in South Africa have been contracting for more than four years, making the current downswing the longest recession of this century. The downward trend started in the seventies with declining but still positive growth rates, whereas in the last four years the economy declined in absolute terms. The economic downturn has not only been abnormally long, it has had more serious repercussions for living standards and employment than most other downswings, barring the Great Depression of the thirties. In an environment where the labor force kept rising at a rapid rate, employment opportunities in the formal sector decreased sharply. Consequently, 1.5 to 3 million people have been unable to find employment in the formal nonagricultural sectors since the beginning of the recession.²⁵

The inability of the formal sector to absorb free labor is positively related to the formation of microenterprises. Simultaneously, the deregulation strategy to promote the creation of employment lowered barriers to entry (enforcement of 'illegally' operating businesses). Between 1960 and 1990, the percentage of the population without formal employment increased from 33 percent (2.2 million people) to 51 percent (8.4 million people). The average annual increase in formal employment between 1985 and 1990 (33,000 employees) was less than one-quarter of the average annual increase between 1960 and 1975 (157,600 employees). By the 1985-1990 period, the formal economy absorbed 8 percent of the new labor market entrances compared to an absorption rate of 81 percent in the 1960-1965 period. The current official unemployment figure is 14.9 percent.²⁶ More realistic estimates arrive at figures of up to 60 percent including the homelands. The people hit the worst by the crisis were the blacks. In order to enable them to earn a living, most

²⁴ Jerry Eckert "Strategies for Smaller and Informal Enterprises," Draft for Development Strategies (not yet published), p. 11.

²⁵ Standard Bank, Quarterly Economic Review, No. 2 (Johannesburg, Standard Bank, 1993), p. 1.

²⁶ Development Bank of Southern Africa, Labour and Employment, p. 15.

were forced into self-employment either on a formal or informal basis, where the vast majority opted for the latter.

The predominant reason to become an entrepreneur was due more to necessity than to the typical reasons of independence and increasing income possibilities. Most of the newly formed enterprises belong to the category of survival orientated enterprises with little potential to grow. The lack of managerial capacity and skills is responsible for the concentration of less profitable enterprises in extremely competitive markets.

On the other hand, a substantial number of the enterprises have high growth potential. Many entrepreneurs took advantage of the more favorable legislation to risk self-employment with opportunities for success and enormous potential.

III. Characteristics, Problems and Constraints of Small and Microenterprises

A. The Data

Data about South Africa's small and microenterprise sector is scarce and most studies were done only recently.²⁷ This is due to two reasons: The national policies biased toward larger and public enterprises and the international boycott which kept South Africa isolated and out of the network of research activities conducted elsewhere. A shift in national policies occurred in the eighties and not until then was interest focussed on the sector. Increasing economic problems and in turn political instability forced the government to change its attitude toward the black small and microenterprise sector. Political unrest was supposed to be dampened by elimination of increasing unemployment through the promotion of self employment because the formal modern economy was no longer able to cater to the increasing labor force. Restrictive legislation was removed step by step, research units at several universities were established, and the Small Business Development Cooperation, a parastatal and indirect instrument of the regime, was urged to extend its services to blacks. Together with the worldwide trend to free market policies and the view of the private sector as a panacea, the South African policies shifted from a dirigistic state owned economy toward privatization. Furthermore, in the nineties international sanctions started to erode accompanied by an inflow of international organizations attempting to fulfill their mandate of assisting the disadvantaged black population in economic support and political and social empowerment. Small and microenterprise development was and is seen as a major contributor toward those goals.

The promotion of small and microenterprises has been declared a priority by most of the parties represented in the new government. Sound policy formulation and recommendations

²⁷ Only one survey can be regarded as a complete census of businesses, but it covers only two townships which restricts the results to a specific area. All others surveys are based on small samples mainly covering a specific region.

concerning both the demand and the supply side of promotional instruments are founded on a meager database. In addition most surveys were conducted only recently indicating the learning process in the field. Results differ widely and are inconsistent. Existing studies are scattered and nationwide coordination has not yet been achieved. Drawing from international experience is also limited because of the unique South African problem.

In the future it can be expected that interest in small and microenterprise issues will increase and research activities will focus on the issue, this will broaden the urgently needed data base in order to formulate sound policies for small and microenterprise development without influence by apartheid policies. There are a lot of studies in the pipeline not yet released; others are in private hands and public access is limited. A summary of existing and accessible studies with their characteristics is presented in Table 3.

Only the World Bank Report can claim a certain countrywide coverage, although the vast heterogeneity of the homelands which will be part of the New South Africa was left out. All other studies are extremely narrow in their geographical outreach focusing on the urban areas of the country. Rural, non-metropolitan areas where poverty is concentrated and the typical Third World problems are obvious receive less attention.

In general it is quite unclear in most of the studies if small and microenterprise development is seen as an instrument of poverty alleviation or a strengthening of private sector development. A distinction is necessary in order to formulate and evaluate programs.²⁸ Depending on the objective of each study, be it program evaluations, feasibility studies, or identification of bottlenecks, the results and emphasis differ and make comparisons difficult. A synopsis of the entire national picture of the small and microenterprise sector is impossible.

Only a few of the studies use subsector approaches to understand differences in certain sectors.²⁹ The trend toward broad identifications of problems faced by entrepreneurs might be useful in the beginning, but a thorough analysis of one aspect promises more information. This one stop shop approach is still widely used by organizations offering services to small and microenterprises. International experience shows that specialized institutions are more successful than those with 'a little bit of everything' approach.³⁰

²⁸ Mohini Malhotra, "Poverty Lending' and Microenterprise Development: A Clarification of the Issues", GEMINI Working Paper No. 30 (Maryland, GEMINI, 1992), p. 5.

²⁹ James J. Boomgard et al., "A Subsector Approach to Small Enterprise Promotion and Research," World Development, Vol. 20, No. 2, pp. 199-212.

³⁰ Judith Tendler, "Whatever happened to poverty alleviation ?" in Jacob Levitsky (Ed.), Microenterprises in Developing Countries (London, Intermediate Technology Publications, 1989), pp. 26-56.

Table 3: Characteristics of Studies about Small and Microenterprises in South Africa.

Study	Author	Organization	Title	Year	Region	Area	Types of Enterprise	Sector	Sample	Observations
A	Carl Liedholm Michael McPherson	GEMINI	Small-Scale Enterprises in Mamelodi and Kwazakhele Townships, South Africa: Survey Findings	1992	Mamelodi, Kwazakhele	urban townships	small and micro	all	5253	Thorough survey but in only a very limited area
B	T. Riley Carl Liedholm	World Bank	Characteristics of and Constraints Facing Black Businesses in South Africa: Survey Results	1992	several	different	micro, small, medium	all	630	Report is summary of several sub-studies and includes GEMINI study data
C	Mark Schacter	World Bank	Microentrepreneurship in South Africa: The Impact of Regulation and Support Services	1992	several	different	micro	all	620	Focus on regulatory issues and support organizations, partly similar to other WB study
D	Nicoli Natrass	World Bank	The Small Black Retail Sector in South Africa	1992	several	urban townships	small and micro	retail	100	Retail sector only, more and less established enterprises
E	Pinky Mashego Claudia Manning	n/a	Informal Manufacturing in the South African Economy	1992	Cape, Jo'burg, Durban	urban	small and micro	manu	50	Clothing, wood-work and metal sector, few data, more descriptive in nature
F	n/a	RFF	Group Credit Scheme Pre-Feasibility Study for the Herschel District of the Transkei	n/a	Transkei, Herschel District	rural	small and micro	all	159	Emphasis on income generating activities, feasibility study for program implementation
G	Consumer Behaviour Pty Ltd.	NAFCOC/US AID	Survey of Black Enterprises and their Attitudes Towards NAFCOC, Vol. III	1987	Transvaal, Natal, Cape	urban	micro, small and medium	all	300	Report outdated, covers only urban areas and townships
H	Ros Hirschowitz et al.	HSKC	Investigation into Training for the Informal Center Financiers and Their Views on Informal Businesses	1991	16 areas	urban	informal enterprises	all informal	168	Types of financiers of informal enterprises, formal, semi-formal and informal credit sources are considered, training needs are identified
I	Marielle Zeidler	Friedrich Ebert Stiftung/The Ohio State University	Financial Services and Small and Microenterprises in South Africa: Status, Problems and Potential	1993	Lethabile, Tzaneen	peri-urban, rural	small and micro	all	48	Focus on rural areas but non-representative sample consciously chosen

The importance of institutions in development, emphasized by the institutional and information economists, has not yet found its way to South Africa.³¹ Most of the studies are still looking at impacts on end users in their evaluations, such as contribution to augmentation of household income after loan disbursement instead of the institutional sustainability of the supplier of services for small and microenterprises. Only one detailed evaluation of institutional performance exists. A combination and link between the two sides of the market are necessary to cope effectively with the problem. In terms of the supply side the current international experience draws attention to institutional development and its contribution toward development and change. Data hardly exist. Financial services, training, and technical support should be researched separately. The focus on the demand side of services is one of the deficiencies in existing information. But what is the use of lists of problems and services required by enterprises when the current programs of suppliers are unknown?

The emphasis and steadily increasing attention given to small and microenterprise development in South Africa at the moment is accompanied by increasing research efforts of various national and international organizations and universities. A lack of coordination exists on national and regional levels.

B. Characteristics of Small and Microenterprises

This section provides a brief overview of the findings of the studies listed in Table 3 of small and microenterprises in South Africa.³² Distinctions between rural and urban areas are examined. If available data suggest differences in characteristics of rural and urban enterprises, it will be indicated in the form of *italics* in the following listings.³³

Magnitude of small and microenterprises in the economy

³¹ The theoretical framework of the role of institutions in development can be found in, Douglass C. North and Robert Paul Thoma "An Economic Theory of the Growth in the Western World," The Economic History Review, Vol. XXIII, No. 1, (1970), 1ff.; Douglas C. North, "Three Approaches to the Study of Institutions", David C. Colander (Ed.), Neoclassical Political Economy (Cambridge, Ballinger, 1984), p. 33.

³² The information given here is a combination of findings of the studies listed in table 3.

³³ Data on characteristics of and problems and constraints faced by small and microenterprises in rural areas is nonexistent. If surveys include rural areas a distinction between differences among rural and urban enterprises was not attempted. The small survey done by the author in Lethabile and Tzaneen/ Northern Transvaal focusses on non-metropolitan areas, but is extremely limited because the sample size and the small regional coverage does not allow a generalization. It was seen more as a consciousness raising effort to address the rural small and microenterprise sector than as a description of it.

- There are at least 10,000 registered black enterprises throughout the country contributing to a total value of about 1 to 1.5 percent to GNP.
- Black business operating in the informal sector are estimated to number about 400,000. They contribute an estimated 8 to 12 percent to the GNP of the national economy.
- Estimated employment increased from about 20,000 in 1975 to 1.5 million in 1990, indicating the increasing importance of the sector as contributor to economic life.
- A mean monthly turnover of Rand 1502.00 and a median of Rand 800.00 are reported. Sectoral differences reveal a low level of turnover in the traditional, easy entry sectors mainly operated by women.
- Entrepreneurial activities provide more than half of the total household income.
- Black enterprises tend to be new. About 50 percent and more were created during the last three years.
- In comparison to other African countries, the density of black small and microenterprises is low (36 enterprises per 1000 people).
- *The percentage of small enterprises in rural areas is even lower and the share of survival orientated microenterprises is higher.*
- *Rural enterprise income provides a higher share of total household income than urban enterprise income.*

Sectoral distribution of small and microenterprises

Typical of South Africa's small and microenterprise sector is the domination of the retail sector, followed by services and finally manufacturing. As shown in table 4 figures reported by the various studies differ. This can be explained by the diverse objectives the individual studies were aiming at or the discrepancies in classifying the enterprises. E.g., the high retail sector figure of 70.4 percent from GEMINI (study A) results because of the inclusion of shebeens and restaurants under retailing, whereas all other studies record them under services. Because these enterprises form a substantial part differences become and are included in all other studies as enterprises belonging to the services sector. The higher figures in the manufacturing sector of the SBDC study and study F on the other hand can be explained by the business policy these companies are following. As traditional organizations promoting small and microenterprises their focus is primarily on firms involved in manufacturing and services as it is regarded to be more productive and add more value to the whole economy. But compared to other countries (36 percent in Lesotho and 32 percent in Niger), the share of manufacturing businesses in South Africa is still low; ranging from 14-36 percent.³⁴ This can be explained by the sophisticated formal manufacturing sector using mass production technologies, relatively low prices, and a less segmented market. On the other hand, apartheid policies restricted the access of black people to obtain the necessary skills. Traditional

³⁴ Carl Liedholm and Michael A. McPherson "Small-Scale Enterprises in Mamelodi and Kwazakhele Townships South Africa: Survey Findings," GEMINI Technical Report No. 16 (Maryland, GEMINI, 1991), page 6.

manufacturing plays a role only in certain regions.³⁵ Those products are in low demand and cannot compete with the sophisticated non-durable consumer good market in South Africa.

Table 4: Sectoral Distribution of Small and Microenterprises

Study ^a	Sub Sectors		
	Retail	Manufacturing	Service
Kirsten	55	23	31
CSO	46	23	31
A	70.4	16.9	7.1
SBDC	38	32	9
ACHIB	40	14	26
I	45.8	16.6	37.5
G	44	20	38
F	48.3	36.3	15.4

a: The data from Marié Kirsten, the Central Statistics Office (CSO), the African Council of Hawkers and Informal Businesses (ACHIB) and the Small Business Development Corporation (SBDC) was extracted from: Claudia Manning and Pinky Mashego, "Informal Manufacturing in South Africa," p. 30.

Slightly higher manufacturing activities are reported from studies which included rural areas but due to the scarcity of data from rural areas a generalization seems not yet appropriate. Rural manufacturing is more linked to traditional and agricultural production. Grass thatching, pottery, traditional pharmacy, etc., are more significant than in urban areas.

The small and microenterprise sector is extremely narrow in its diversity. A few activities form the majority of the sector. All activities are earmarked by low barriers to entry leading to increasingly stiff competition with low profits. These mainly retail and commerce activities form a substantial of the small and microenterprise sector but are often neglected by the traditional approach to promote entrepreneurship. A shift toward a greater share in manufacturing enterprises is only possible in the long term because of the necessity of obtaining relevant skills. But even then it is unlikely that small manufacturers can easily compete with their larger counterparts in the formal sector. Here market niches must be found where small producers have a comparative advantage. The possibility of business linkages can play a role in a diversification process which could also break up the economic power concentrated among the three big conglomerates currently dominating South Africa's economy.

³⁵ Rural traditional activities are strongly related to natural endowment of specific regions. Eleanor Preston-Whyte and Christian Rogerson (ed.), South Africa's Informal Economy, (Cape Town, Oxford University Press, 1991).

- In the trade and commerce sector, the most common business activities in descending order are: retail trade, shebeens, hotels, bars and wholesale trade. Street vendors form the majority of retailers.
- In the manufacturing sector, light manufacturing (production of so-called soft goods) dominates, with textile, wearing apparel and leather production, food, beverage and tobacco production, and wood and metal production following.
- Less diversification and specialization exist among all enterprises.
- *The range of different activities is lower and more dependent on regional cultural differences and natural endowments in rural areas than in urban areas.*
- *Rural enterprises are more linked to agricultural production than in urban regions, but in comparison to other African countries linkages to the agriculture sector are lower.*

Size and employment

- Medium and large black enterprises are generally nonexistent; the majority of black businesses are small and microenterprises. The latter outnumber the former.
- In the microenterprise category, the survival orientated predominate; most were pushed into self-employment earning less than R 650.00 which is officially defined as country-specific subsistence level.
- The lower and upper bounds for size and employment are lower. The paucity of the upper end results in a missing middle in the size distribution; only 1 percent range between 11- 50 workers.
- Size differences arise from the type of business sector (construction averages 4.6 workers, manufacturing 2.39 and the lowest is the trade sector with an average of 2.06 workers).
- Manufacturing firms and certain retailers are the largest (butcheries, bottlestores, general dealers) due to protected licensing in the former years.
- 97 percent of black enterprises have five or fewer workers (other middle income countries have only 11 percent in this range)
- *The average size of rural enterprises (1.8 persons) is less than the average of 2.1 workers per firm in urban areas.*

Growth

- Half of the businesses grow in terms of employment and half do not, among which 2 to 3 percent report they are shrinking.
- Growth is inversely related to the age of the operator and the initial size of the enterprise.
- Growth rates are sector specific with an indication that the manufacturing sector, with the exception of soft good manufacturing, is the fastest growing and the retail and service sectors are the slowest.
- *Rural enterprises grow slower and more of them are shrinking.*

Gender

- Men dominate in the small enterprise sector, comprising 70 percent of it, while women dominate in the microenterprise sector, representing 62 percent of ownership.
- Women's enterprises are concentrated in sectors with the lowest level of profitability and growth in employment; the average sizes of male and female enterprises are 2.63 and 1.71 respectively.
- Women enterprises contribute less than male enterprises to total household income.
- Female enterprises are a higher proportion of firms earning incomes below the subsistence level of R 650.00.
- *Women ownership of enterprises is higher in rural areas where 70 percent of all enterprises are owned by females.*

Entrepreneurial background

- Entrepreneurs tend to be young; 35 percent are less than 30 years old.
- Two-thirds of the entrepreneurs are functionally literate which is high in comparison to other developing countries.
- The vast majority of operators do not have fathers who operated a business.
- The majority of enterprises were initially funded with less than R 500.00.
- Start-up capital came mainly from owners savings or loans from friends and family and other informal sources.
- Most enterprises do not meet the lending criteria of banks, neither for working nor start-up capital.
- 60 percent of enterprise owners are members of stokvels and burial societies.
- The majority of entrepreneurs received no business or skills training.
- *Stokvels and burial societies seem less important as sources of borrowing in rural areas; only two-thirds reported membership in ROSCAs.*
- *A lower education level among rural entrepreneurs is observed than their urban counterparts.*
- *Only 20 percent of rural entrepreneurs had some business or skills training.*
- *Younger rural entrepreneurs are more dynamic, risk prone, diversified in business operations, and have a higher turnover than the older rural entrepreneurs.*

Institutional support

- Only 10 percent approached support agencies for advice; 50 percent do not know about them and 39 percent find it difficult to contact organizations.
- The higher the educational level of the entrepreneur, the higher was the contact rate with support organizations.
- 41 percent of the 10 percent who contacted an institution received assistance, and their average monthly turnover was R 3.604 compared to R 2.114 for those not receiving assistance.

- Growing age of the firm, led to a decline in the percentage of assistance received, and it increases after 4 years of operation (proven track record).
- *The reach of small and microenterprise support organizations in rural areas is extremely limited.*
- *Support organizations tend to be concentrated in certain rural regions.*

C. Problems and Constraints: The Demand Side

Most of the above mentioned studies limit their evaluations of small and microenterprises to a qualitative description of criteria constraining the firms in question. Only a few used a data set allowing them to quantify their results. Therefore, any comparison of empirical data is extremely limited.

Most of the studies fail to give an indication of the magnitude of enterprises facing problems in their operations, discounting the possibility of running a business without problems. Another overestimation of the problem of enterprises is the type of questions asked in questionnaires. Data indicates that open ended questions reveal far less problems than predetermined questions where the interviewee can choose among sets of preformulated answers. There appears to be a kind of spoonfeeding and bias in the studies to suggest that enterprises must have problems. Table 5 shows that approximately one third of entrepreneurs do not face problems at all.

Table 5: Do Small and Microenterprises have Problems in their Business Operations?

Study	Problems (%)		No Problems (%)	
	start-up ^a	current	start-up	current
A	60	66	40	33
I	71	87.5	29	12.5
G	79.9	n/a	20.1	n/a

a: Entrepreneurs were asked whether they faced problems in starting a business or during current business operations.

The trend that enterprises face more problems in their current operations than during start-up should be regarded with caution. International experience suggests that problems related to starting a business are higher. A reason for the different results in South Africa might be the extreme adverse economic situation.

Table 6 summarizes the findings of the different studies identifying the most common problems entrepreneurs regard as a restriction in the development of their enterprise.

Table 6: Major Problems of Small and Microenterprises.

Problems	A		I		G		C	
	(in percent)		(in percent)		(in percent)		(in percent)	
	start-up	current	start-up	current	start-up	current	start-up	current
Market	34.6	26.7	24	66.6	10	n/a	32	51.2
Finance	28.8	27.8	29	23.8	28	n/a	22.5	9.4
Legislation	10.9	10.2	47	4.7	20.7	n/a	12.3	6.8
Premises	5.1	10.8	58.8	47.6	20.9	n/a	18	15.7
Transport	6.4	9.7	55.8	23.8	n/a	n/a	4	3
Training	0.6	2.4	5.8	9.4	n/a	20.9	2	1
Violence	n/a	n/a	0	4.7	n/a	41.6	4.4	7.2

Ranking highest among the more recent studies are market related problems like increasing supplier prices, stiff competition in already saturated sectors which in turn leads to fewer customers per enterprise, and a feeling of decreasing demand by the entrepreneur. Table 6 suggests that only in study G, which was undertaken in 1987 when the overall economic situation was more favorable, did market related problems rank lowest and seem not to be a concern of entrepreneurs. This is evidence that the major constraint hindering entrepreneurs in their development must be addressed on a macro rather than a micro level. Policies aimed at economic recovery seem to help entrepreneurs more than directly on business operations targeted programs.

The decrease in problems related to legislative regulation since 1987 (20.7 percent then, to a range of 4.7 to 10.2 percent in business operations today) as indicated in table 6, reflects the change in attitude of the government toward small and microenterprises; either removal of restrictive legislation and/or a more lax enforcement of still existing restrictive laws than ten years ago might be the reason. Study C which looked in more detail at the impact of regulations concluded that the legislative environment improved substantially.

The low percentage of respondents viewing the lack of training as an unimportant constraint is interesting. Table 6 and 7 indicate that, once seen as a favorite tool for small and microenterprise development by policy makers, the demand is amazingly low from the perspective of the entrepreneurs themselves. Also the oldest study (study G) reports higher percentages which could be an indication that market related obstacles currently are dominating all others. Study I, undertaken in rural areas, suggests that transport and related problems are far higher than in metropolitan areas. This is not too surprising because of the less established infrastructure in those areas.

Table 7: Major Problems of Entrepreneurs: Spontaneous Versus Predetermined Responses.

Study Types of problems	I				C		
	spontaneous (in percent)		predetermined (in percent)		spontaneous (in percent)		prede- terminated ^a
	start-up	current	start-up	current	start-up	current	rank
No Problems	45	39	29	12.5	n/a	n/a	n/a
Problems	55	61	71	87	n/a	n/a	n/a
Market	20	71	24	82	32	51.2	1
Finance	18	16	29	24	22.5	9.4	4
Legislation	34	8	47	5	12.3	6.8	5
Premises	12	28	59	48	18	15.7	3
Transport	22	11	56	24	4	3	2
Training	0	2	6	9	2	1	6
Violence	0	1	0	5	4.4	7.2	3

a: This study used a ranking order of a list of predetermined problems listed where 1 indicates the most pressing problem.

Entrepreneurs respond less to questions of problems in their business operations with spontaneous responses. This is not surprising given the tendency of human behavior to use the easiest route in answering a questionnaire where they do not benefit directly and immediately from the results. Responses to financial related problems tend to increase due to expectations of obtaining cheap funds. On the other hand, financial problems tended to decrease in importance when asked spontaneous.

A breakdown according to the three subsector approaches might indicate specific sector related problems. This kind of analysis was used only by study B so far.

The results presented in table 8 do not differ significantly from the general identification of problems. Business environment related issues like township violence, gangsterism and theft rank highest because this survey was done in the urban townships of Johannesburg, Cape Town and Durban only, where violence is a constant part of daily lives.

Table 8: Constraints Facing Black Enterprises in Different Subsectors.^a

	Retail			Construction			Taxi		
	Survival	Potential Dynamic	Dynamic	Survival	Potential Dynamic	Dynamic	Survival	Potential Dynamic	Dynamic
Business Environment	3.82	3.66	3.73	2.98	3.32	2.82	3.2	3.3	2.88
Finance	3.03	2.93	2.8	2.9	2.59	2.38	3.05	2.95	3.04
Markets	3.12	2.86	2.94	2.82	2.73	2.57	2.99	3.01	2.64
Regulations	2.44	2.17	2.76	2.3	2.2	2.34	2.13	2.37	2.04
Skills & Labor	2.44	2.74	2.76	2.72	2.6	2.25	2.88	2.93	2.31

a: The table is a combination of separate tables from Carl Liedholm and Thyra Riley "Characteristics of and Constraints Facing Black Businesses in South Africa." Scores are based on a scale of 1 to 5 in which constraints ranked closed to 1 are the least severe and those ranked close to 5 are the most severe. The figures reported in the five categories are the weighted averages of a subset of identified problems. Enterprises were categorized in view of their demonstrated dynamism. Those with the highest potential to grow are defined as dynamic, survival orientated with no growth potential. As potential dynamic classified firms, are those in-between the two extremes.

Market related issues are one of the most pressing problems in all subsectors, especially the high cost of supplies mentioned by retail and transport sector enterprises. Survival orientated and more dynamic enterprises are affected in the same way. In the retail sector the high inflation rate which can not be rolled over quickly due to the stiff competition in this market is responsible for steadily increasing supplier prices. In the transportation subsector (black taxis) the high prices of vehicles are related to South Africa's highly protected local vehicle production. The taxi sector is the only sector where blacks dominate (97 percent of owners) and it is estimated that this sector contributes 1.7 percent to formal sector GDP. It is self-regulated and highly organized. Entrance fees and certain route rights have to be 'bought'. Stiff competition characterizes this sector and peaks in the so called taxi wars. Access to finance constrains this sector more than others because of relatively high investment costs and bank knowledge about the rough, highly competitive situation.

The construction sector has gained special attention from research groups. The pressing low cost housing needs of the South African population must be addressed. It is hoped that the black construction sector with labor intensive techniques can participate in proposed programs for low cost housing. According to the detailed results of the study B, this seems rather limited because of fundamental problems related to both internal management weaknesses and the external business environment. Black contractors are found mainly in the unsophisticated lower end market. A lack of training was mentioned by 88 percent as a major constraint in comparison to other subsectors where the demand for training remains marginal. Access to loans is another major problem. Because of township violence, rent boycotts, and difficulties of foreclosing on properties owned by blacks, banks are loath to finance black housing. Here the lack of property rights and legal enforcement of them seem to be the major handicap.

Overall the subsector results summarized in table 8 are in accordance with the more general survey results. The high cost of materials, access to loans, skilled labor, access to land, competition, and preference given to white enterprises are dominating problems faced by the entrepreneurs. The

report indicates as well that the two major problems are specific to external circumstances and might decline substantially if South Africa attains internal stability.

The most striking result of all the studies is that the 'traditional' problems such as training, credit, etc., constraining small and microenterprise in their development are playing a far lesser role than in other countries. This may be because severe economic and legal apartheid problems are overshadowing problems which would be more prevalent in a 'normal' situation. Economic and legislative issues are strongly related to South Africa's political situation characterized by uncertainty. In a climate like this it is not surprising that finance is not a constraint because no one plans to invest in his or her business in this difficult situation. Because the profit situation of those enterprises is affected by the adverse economic situation, the entrepreneurs do not want to take up loans because they fear they will not be able to repay.

Another explanation for the 'lack' of the typical problems which development organizations always want to address can be that the current support organizations are functioning better than in other countries and reach their clients. Section three will look at this issue.

D. Finance--A Major Obstacle?

A remark about the data of financial needs and credit is necessary to determine the reliability of the resulting information. Also in this section the lack of reliable data poses problems and restrictions. It becomes obvious that pulling observations from several documents when making specific points gives only general insights but does not give good, reliable data about several characteristics drawn from the same study for a specific sample. Compatibility and comparability are extremely limited and results must be regarded with caution. In addition data specifically about financial issues tend to be extremely difficult to obtain correctly. This is due in part because borrowers are reluctant to provide information about their debts, because it is seen as a bad thing to have debts. Another reason is related to the types of questions asked.³⁶

It is obvious that when entrepreneurs were asked for spontaneous responses rather than preformulated choices of answers, finance as a constraint was less often mentioned. A further error overestimating credit as a constraint enters when asking the entrepreneurs for the purpose of a loan that they wanted to receive. In study I from those who mentioned credit as a major constraint, only 10 percent of the entrepreneurs came up with an concrete answer about how they would use a loan to improve their business. If checks like this are not included, finance as a constraint tends to be overemphasized.

³⁶ This problem is addressed in detail in e.g. Christopher Udry, "On Collecting Data on Credit in Africa," (Evanston, Illinois, Department of Economics Northwestern University, 1992), photocopied.

Apartheid policies had denied black entrepreneurs directly simply because of racist attitudes³⁷ and indirectly through poorly defined property rights access to the formal financial system.³⁸ The reason is not as in several other countries where, for example, high transaction costs are one reason for rural entrepreneurs to be excluded from the formal financial system. South Africa has a dense network of formal financial institutions. Branches of commercial banks are found in rural towns all over South Africa.³⁹ Distances to formal financial institutions as one component of transaction costs are far lower than in other countries where the nearest bank is dozens of kilometers away. The coverage of the NGO framework, where blacks at least had a better chance to obtain loans, is low and concentrated only in certain regions. This might give evidence that small and microentrepreneurs indeed have an unsatisfied demand for credit.

One issue which has not been addressed in South Africa is the difference between programs aimed at private sector development versus poverty alleviation through the provision of financial services. These objectives require different strategies. International experience shows that programs for poverty reduction hardly contribute toward the goal of employment creation, income redistribution, and private sector development. The majority of microenterprises are survival oriented and improvement of credit access is related more to poverty alleviation.⁴⁰ On the other hand, the demand from highly dynamic enterprises for financial services must be dealt with differently.

Four major types of finance related issues are reported by entrepreneurs as difficult to achieve. As shown in table 9, they are investible and operational funds as well as not available or cheap credit.

³⁷ In the study of Hirschowitz a simulation approach was used where a white and a black fieldworker tried to obtain a bank loan. There is clear indication that in South Africa access to finance is still related to race.

³⁸ The role of well defined property rights in development is discussed by Douglas North, "An Economic Theory of the Growth in the Western World," *The Economic History Review*, Vol. XXIII, No. 1, 1970, pp.1-17.

³⁹ The First National Bank Ltd., one of the biggest commercial banks, operates through a network of 530 branches.

⁴⁰ The differences between poverty lending and market orientated programs became a subject of controversy only recently. For example Mohini Malhotra "Poverty Lending' and Microenterprise Development"; Sharon L. Holt and Helena Ribe "Developing Financial Institutions for the Poor and Reducing Barriers to Access for Women," World Bank Discussion Paper No. 117 (Washington, World Bank, 1992); Robert V. Pulley, "Making the Poor Creditworthy," World Bank Discussion Papers No. 58 (Washington, World Bank, 1989).

Table 9: Types of Finance Related Problems.

Problems	A			I	G
	(in percent)				
	start-up	during growth	current	current	current
Lack of investment funds	7.7	7.8	10.8	16.6	44.2
Lack of operational funds	16.7	10.7	10.2	11.9	30.1
Unavailable credit	4.5	1.9	6.8	0.4	19.3
Cheap credit	n/a	n/a	n/a	n/a	2.2

In many of the studies and policy papers the lack of access to finance is identified as a major bottleneck prohibiting enterprises to grow. Either no data backs up those conclusions which makes it difficult to justify costly intervention into the credit market, or a relatively small proportion of enterprises reporting credit demand is sufficient to regard it as a major problem. Looking at the magnitude from the demand side, if 40 percent of people claim to have no problem in business operations, and from the remaining 60 percent roughly 20 percent mention finance as one problem, it is hard to imagine that this should be considered a key problem requiring urgent action. The argument for financial intervention seems to stand on a weak footing and the use of expensive programs seems needless.

The frequency with which South African entrepreneurs work with borrowed capital is indicated in Table 10.

Table 10: Loan Sources used for Business Operations.

Loan Source	Percent
Received Loan	50
Received no loan	50
<i>if yes, from:</i>	
Formal sector	8.3
Semiformal sector	29.2
Informal sector	62.5

Source: study I.

Half of all enterprises received loans during their business lifetime drawing in the vast majority of cases from informal sources like family, friends, stokvels, and moneylenders. Only a marginal percentage came from the formal financial system. This picture is in accordance with other countries where the bulk of loan sources are covered by the informal sector. Whereas every second enterprise used loans during its operation, the start up of enterprise activities is primarily self-financed as shown in table 11.

Table 11: Start-up Capital Sources.

Source to start	Percent
Personal savings	91.6
Mixture of own & informal	34.1
Formal or semiformal	8.3

(Source: study I)

From those enterprises interviewed, over two-thirds operate an account in the formal financial sector. 84.8 percent have an account with commercial banks, and 15.2 percent hold an account with the post office. As shown in table 12 the majority of formal accounts are savings accounts as is the case in other countries where clients have a strong savings need. A study among the black population states a higher savings rate than that of their white counterparts.⁴¹ This is an indication confirming international experience that poorer segments of the population look previously for deposit facilities as an insurance mechanism in order to smooth income rather than loans. The countrywide dense net of commercial banks in comparison to other Sub-Saharan African countries enables a broad segment of the population to access the formal financial system without high transaction costs. Due to apartheid, only a savings culture with commercial banks could be established. Formal loans were out of the picture and only a few alternatives to the informal sector were available.

Table 12: Usage of Formal Financial System and Types of Accounts.

Type of Bank Account (Percent)	
Savings	66.67
Current account (hire purchase)	3
Current account (overdraft facility)	24.2
Club account	6

Source: Study A.

The club account offered by some banks is a relatively new financial product based on the methodology of the stokvel operations. Banks could achieve access to black saving groups not yet tapped by the formal financial system. It opened up an opportunity for stokvels to operate via the formal financial system. This is an good example of how banks can access those marginal clients if they are innovative enough and 'borrow' ideas from the informal financial sector.

⁴¹ C.E.W. Simpkins, "Black Financial Behaviour: An Assessment" in Report of an Appropriate Basis for and the Feasibility of Community Banking in South Africa, (Johannesburg, Community Banking Project, 1992), Appendix II.

The main reasons for not operating a bank account were centered around racial exclusion and no knowledge of operations as shown in Table 13. A certain psychological barrier towards those formal financial institutions was often mentioned.

Table 13: Reasons for not operating a Bank Account.

Reasons for No Account (Percent)^a	
Reasons related to apartheid	64.8
No idea about operation	31.25
Inconvenience	31.25
No money to keep	31.25
n/a	6.25

Source: study I.

a: More than one answer was possible, therefore, the total exceeded 100 percent.

One can observe a certain self-rationing attitude among entrepreneurs. Whereas only a minority had turned to formal financial institutions to satisfy their credit needs, the majority had not tried it at all as seen in Table 14. The entry barrier seems to be high. For those 16.6 percent who tried to qualify for the banks lending criteria, only one quarter succeeded. The main reason for rejection of loan applications was lack of collateral. The general low contact rate of small and microenterprises with commercial banks is comparable to other services supporting this target clientele.

Table 14: Efforts to Obtain Formal Loans.

Ever tried to get bank loan	Percent
yes:	16.6
accepted	4.1
rejected	12.5
no:	81.3
n/a	2.1

Source: study I.

On the demand side for support services, study C observed that only one out of ten entrepreneurs had made contact with an organization. The main reasons were that they had not heard about any organizations, they are hard to contact, and that the entrepreneur cannot leave business premises. 31.3 percent of the sample did not feel a need for support at all. From those seeking support over fifty percent looked solely for credit and 18.6 percent for a combination of credit and training. Study I which was conducted in non-urban areas obtained higher contact rates. This is

because in both communities one support organization was present, which is an exceptional case in South Africa and cannot be generalized. But in both areas the number of clients served differed a lot. Whereas in Lethabile a community of about 24,000 people served by approximately 400-500 microenterprises, the Small Business Development Corporation had only 29 loans outstanding in its portfolio. In comparison in the Tzaneen area with an approximately similar population, the Small Enterprise Foundation had about 1400 loans outstanding. In an interview with this organization it was mentioned that they cannot handle the high demand for their products.

With the exception of the latter case these figures emphasize the narrow reach of those organizations. If one also takes into account study C, in which 32.5 percent of people contacting an organization received support and only two-thirds of them thought the assistance was useful for their business, quantitative and qualitative improvement of services might have potential.

Whereas the demand side is only one part of the whole problem, considerations about constraints are often only seen from the demand side. To gain a more complete picture the suppliers of financial services must be considered as well to gain an impression of the extent and qualitative nature of the problem as the above example illustrates.

Like other problems finance has to be regarded under the adverse South African situation. It has to be taken into account that all the data were gathered under an extremely adverse environment for black entrepreneurs. In an unpromising economic environment no entrepreneur will take the risk to borrow not knowing how he can repay. In the survey in 1987, when the economic situation was acceptable, finance as a problem ranked far higher, but repayment was not considered a problem. Expectations of obtaining cheap funds was not an issue here. Lack of access to the formal banking system was a bigger issue than high interest rates.

What can be stated is that finance is a certain obstacle for entrepreneurs but should not be overestimated because of a general overall international experience and an rather unsound data base which is overshadowed by other more pressing problems at the moment. Further research should be encouraged. Rejected access to finance caused by racism has to be removed first or simultaneously with easier access for the different needs of small and microenterprises. It is quite possible that after an economic recovery, finance for small and microenterprise development will matter as a constraint.

With the demand side in mind, the following section 3 will look at the supply side of financial services and address the issue whether the finance constraint can be attributed partly to distortions on the supply side.

IV. Suppliers of Financial Services for Small and Microenterprises

A. Institutional Overview

To gain a fuller picture it is necessary to document the institutional features of the credit market. Sources of loans, the contractual arrangements, and usage of enforcement mechanisms are important for determining an efficient matching of demand and supply.

In theory South Africa's small and microenterprises can satisfy their needs for financial services from a broad selection of formal, semiformal and informal arrangements and institutions forming the financial system of the country. The distinction between the three classifications of financial arrangements should be regarded more as a conceptual framework where a certain arbitrary grouping can not be avoided; in reality they form a continuum from most to least formal in terms of their organization and operation.⁴²

Following this terminology, these institutions are differentiated as follows:

- **Formal Banking** exists in the public sector as national or development banks, and in the private sector as commercial banks. These banks are not well adapted to the needs of disadvantaged people. They are too far removed from this clientele, geographically, culturally, economically, and organizationally.
- **Semi-Formal Banking** exists in the economy as Savings and Credit Cooperatives, Credit Unions, NGO's or other forms of participative banking. These institutions tend to copy formal systems.
- **Informal Banking** exists in the informal economy as self-help groups, self-managed village banks, tontines and Roscas, moneylenders, etc. Informal banking systems tend to be more efficient in adapting to the needs of disadvantaged people. They can reach the target population by improving the quality of services for their benefit. Naturally, this leads to higher transaction costs, a problem for any banking system catering to this group.

Formal and semiformal institutions are operating under the auspices of the law. Financial legislation such as interest rate ceilings and deposit taking requirements restrict financial activities as well as the economy. Informal financial arrangements are characterized by their diversity and flexibility.

⁴² The differences among the sectors are discussed at length in Richard L. Meyer, Douglas H. Graham and Carlos E. Cuevas "A Review of the Literature on Financial Markets and Agribusiness Development in Sub-Saharan Africa: Lessons learned and Suggestions for an Analytical Agenda," Economics and Sociology Occasional Paper No. 2008 (Columbus, Ohio State University, 1992); Hans Dieter Seibel and Michael T. Marx, Dual Financial Markets in Africa: Case Studies of Linkages between Informal and Formal Financial Institutions, (Saarbrücken, Fort Lauderdale, Breitenbach Publishers, 1987); Guy Bédard "Development Banking with the Poor, for the Poor and by the Poor: New Models for Banking", Basic Document (Eschborn, Gesellschaft für Technische Zusammenarbeit mbH, 1991).

The institutional overview presented in table 15, should not be regarded as complete. Rural and urban biased organizations are included. Agricultural lending and lending for income generating activities also cannot be separated. The part about credit unions, cooperatives and the homeland development corporations is weak because of sparse data and time constraints.

Table 15: Overview of Financial Institutions.

Institutions Offering Financial Services to Small and Microenterprises		
Formal Financial Institutions	Semi-formal Financial Institutions	Informal Financial Institutions
Government:	NGOs and other registered Companies:	
<ul style="list-style-type: none"> - Development Bank of Southern Africa (DBSA) (wholesaler) - Gwazankulu Development Corporation - Kangwane Economic Development Corporation - Kwazulu Finance Corporation (KFC) - Lebowa Development Corporation - Other homeland development Corporations 	<ul style="list-style-type: none"> - African Initiative Development Trust - Elim Care Groups - Get Ahead Foundation (GAF) - Get-up! Lending Trust - Group Credit Company - Independent Business Enrichment Center - Lowveld Credit Company - Rural Finance Facility - Triple Trust Organization - Women's Development Banking - Small Enterprise Foundation - Start-up/iBTT 	<ul style="list-style-type: none"> - Burial Societies - Family and friends - Moneylenders - Stokvels - Supplier credit - Pawn shops (reg.)
Parastatal:	Credit Unions:	
<ul style="list-style-type: none"> - Eskom Finance Group - Post Savings Bank - Small Business Development Corporation (SBDC) 	<ul style="list-style-type: none"> - Savings and Credit Co-operative League of South Africa (SACCOL) 	
Private:	Other:	
<ul style="list-style-type: none"> - African Bank - First National Bank (FNB) - Future Bank - Perm Bank - Community Bank - Standard Bank - Trust Bank - United Bank 	<ul style="list-style-type: none"> - Africa Co-operative Action Trust - National African Federated Chamber of Commerce and Industry (NAFCOC) - National Stokvel Association of South Africa (NASASA) - National Union of Mine Workers (NUM) - SABTA (Taxi Organization) - South African Sigan Association 	

At a first glance the overview looks quite overwhelming. Indeed there are about 100 officially registered small business development organizations offering support services for small and microenterprises (one-third to one-half are involved in support of microenterprises as well or solely). Thirty-eight of them consider the provision of finance either in form of subsidized loans (24 organizations), commercial loans (24 organizations), and venture capital (16 organizations) as part

of their mandate. The majority offer these services in combination with seminars, training courses, legal advice, lobbying, marketing support, provision of premises, etc.⁴³ The Development Bank of Southern Africa and the eleven homeland development organizations have a special status. They are provide financial support to other development organizations in addition to their own loan programs. They act as a kind of wholesaler providing loans to those organizations directly in contact with grassroot development and in that way build institutions. Those institutions possess the typical characteristics of development banks and their related problems like subsidized interest rates.⁴⁴

Commercial banks play a minor role in the supply of financial services to small and microenterprises. Their inability to create applicable financial products with appropriate delivery and enforcement mechanisms is apparent. Out of 140 registered commercial banks only about 5 began to access those clientele with special created windows to make those services an integral part of their daily operations. To bridge the reluctance of commercial banks to service those clients, the government and private sector stepped in to create support organizations. Specialized organizations such as development institutions, NGO's, credit unions, etc., were supposed to satisfy the financial needs of small and microenterprises in addition to training and technical support.

Besides these institutions a vast heterogeneity of informal financial arrangements exist. Informal finance is found in urban areas as well in rural areas, often providing the only source of credit for the population not covered or not satisfied by the services of the formal or semi-formal banking system.

A comparison between the four different types of financiers for informal businesses sheds some light on lending practices. The results listed in table 16 are similar to observations in other countries. Unfortunately the study was done for the purpose of identifying training needs, but it is the only study known dealing with the subject directly.⁴⁵ Chosen were 168 financiers in 16 areas. Commercial banks represented 94 interviewees, semi-formal institutions 26 and 51 were from the

⁴³ Centre for Developing Business/University of Witwatersrand, comp., Directory of Southern African Small Business Development Organisations and Agencies (Johannesburg, University of the Witwatersrand, 1993).

⁴⁴ For detailed discussions about the failure of development banks in the past, refer to publications of the International Finance Group of the Ohio State University, Department of Agricultural Economics and Rural Sociology. The Ohio School was the first to point out the difficulties of development banks to access clients and influenced worldwide views about programs such as these. For example see Dale W Adams, Douglas H. Graham and J. D. Von Pischke (ed.), Undermining Rural Development with Cheap Credit (Boulder, Westview Press, 1984); Douglas H. Graham "Designing Financial Intermediaries to Mobilize Savings and allocate Investment Money," (Ohio State University, 1992).

⁴⁵ Ros Hirschowitz et al., "Financiers and their Views on Informal Businesses" in Investigations for the Informal Centre, NIB/HSKC (1991).

informal finance sector, of which 26 were administrators of stokvels or other ROSCAs and 25 were individual moneylenders.

According to criteria the study can be summarized as follows⁴⁶:

Table 16: Financiers and their Lending Criteria.

Criteria	Formal	Semi-formal	Informal Financiers	
	Financier	Financier		
	(in percent)			
	Bank	NGO	Stokvel	Money-lender
No. of interviews	94	26	26	25
No. of black clients	57	42	92	76
No knowledge whether clients are business owner or not	50	31	58	73
Credit ceiling	no	yes	yes	no
Forms to complete	63	81	34.6	16.7
Interviews	76	24	19	20
Fixed interest rate	12	43	29	48
Factors determining flexible interest rates:				
Collateral	23.5	5.7	-	6.7
Risk assessment	19.7	11.4	-	6.7
Viability of business	16.4	40	33.3	-
Creditworthiness	12.6	11.4	11.1	20
Loan amount	11.5	8.6	11.1	20
Loan period	4.4	5.7	-	13.3
Overall economy	10.4	5.7	-	13.3
Community ties	1.6	11.4	44.4	20
Fixed period of repayment	39.4	73.1	56	45.8
Monthly repayments	51.5	73.1	57.7	70.8
Repayment after grant period	13	53.9	34.6	25
Negotiable conditions of repayment schedule	84.8	76.9	73.1	62.5

The data confirm the general assumption that blacks are using the informal financial system mainly for their supply of loans. The relative low usage of financial services offered by semiformal institutions is astonishing taking into account that these organizations see their objective mainly in

⁴⁶

The table consists of a selection of various research findings. *ibid.*, pp. 230-244.

servicing disadvantaged population segments. Whether this can be contributed to racial credit rationing and/or offering products in low demand cannot be determined. Bureaucratic procedures by semiformal financiers (forms to fill out and business plans to be provided by entrepreneurs) might be an entry barrier for entrepreneurs. Business details like goals, market demand, and the location of the business are regarded highly by banks and semiformal institutions in the decision-making process of rejecting or accepting an application. Stokvel administrators and moneylenders are unlikely to look at business details or to require people to complete forms to obtain a loan. The unconventional approach of informal financial lenders again becomes obvious in the nearly non-existent collateral requirements. Informal lenders tend to substitute real assets by human assets. Community ties and creditworthiness of borrowers are the main criteria to assess the mainly oral loan applications. Easily understandable loan modalities are used. Instead of confusing interest rates calculations, moneylenders work with absolute amounts charged for lending; for example, for every R 100.00 at the month's end R 125.00 have to be repaid. Stokvels also operate with fixed contributions from members in predefined periods. Banks are more concerned with minimizing their risk than other financiers. Ownership of fixed property, insurance policies, and proof of steady income are the most important considerations of banks in granting loans. These considerations were less important to other respondents.

Stokvels and moneylenders do not emphasize the usage of loans. The low knowledge of formal banks of loan usage is related to organizational difficulties resulting from overdraft facilities and personal loans for entrepreneurial aims. Semiformal institutions have the highest knowledge of loan usage because they are offering only targeted loans.

The results are not surprising and reflect the same picture as in other countries. Informal lenders have a comparative advantage in accessing marginal clients than their formal competitors. NGOs and other semiformal arrangements tend to be inflexible and so do not reach large segments of the clientele. Appropriate delivering mechanisms and flexible loan contracts are used only by a few organizations.

From a regional viewpoint the formal financial system tends to be present in areas with high economic activity such as the more urban parts of South Africa. Financiers were found in central business districts (43 percent), in suburbs and residential areas (49 percent), and in industrial areas (9 percent). Most of the semi-formal institutions are concentrated in the poverty-stricken black townships in urban areas where lower transaction costs and a certain scale of operations can be expected compared to rural areas. Those institutions are less engaged in rural areas and, if so, they are segmented and service only a small area. In recent times initiatives have strengthened their efforts to service the financial needs of the rural population. Up to now, most of the rural areas where poverty is concentrated were in homeland areas. The main formal suppliers of loans for small and microenterprises were the national Development Organizations, which provide direct loan programs for small and microenterprises and agricultural loan programs where the objective is income generation, in addition to agricultural purposes. Even if information is scarce, those programs tend to have the same difficulties development banks have had in other countries and can be regarded as inefficient.

Table 17: Characteristics of Selected Financial Organizations and their Programs.

Organization	Year started	Region	Targetgroup	Types of Loans	Loan Size (in Rand)	Loan Term	Interest (in percent)	Client Base (current outst.)
African Council of Hawkers and Informal Businesses (ACHIB)/First National Bank	1992	n/a	hawkers	business loans	< 2,000	n/a	commercial	n/a
Future Bank	1992	countrywide	micro	business loans	n/a	n/a	commercial	n/a
Get Ahead Foundation	1987 1989	22 (urban)areas 22 (urban)areas	micro small	working capital working capital	200 - 1,000 1,000-20,000	1 year 3 years	38 n/a	8000 276
Get up! Lending Trust	1985	countrywide	micro	n/a	50 - 5,000	10 days-3 years	1.6/month; 12 upfront charge	286 in four months
Independent Business Enrichment Center	1990	East London	micro	start-up capital	500 - 10,000	n/a	36 effective	50 per month
KaNgwane Economic Development Corp.	~1989	KaNgwane	micro, small	business related	n/a	n/a	n/a	300 planned
Kwazulu Development Corporation	n/a	Natal	entrepreneurs	working capital	> R 200	3 years	17.25-19.25	1800
Lebowa Small Business Dev. Program	1985	Lebowa	small	different types	av.48,000	n/a	n/a	185 annual
National Stokvel Association of South Africa (NASASA)	1992	urban	no distinction	business loans	1,000-20,000	2 years	prime plus 5	n/a
Rural Finance Facility	1991 1991	Brits, Transkei, North Transvaal	micro small	general purpose business related	300 - 1,000 1,000- 3,000	3-6 months 6 months	28.5 28.5	57 n/a
Small Business Development Corporation (SBDC)	1991	countrywide countrywide	micro small	general finance general finance	< 5,000 50-1,000,000	1 year 1-15 years	21 5 commercial	2400 n/a
Small Enterprise Foundation	1991	Tzaneen region	micro	income generating activities	300 / 800 / 1,200	10 weeks / 1 year	nominal 25 effective 45	1345
Standard Bank	1992	countrywide	micro	n/a	200 - 5,000	n/a	n/a	41 (pilot project)
Triple Trust Organization	1988	Cape Town	micro	in kind loans/start-up	880 & 2,100	10 months	n/a	70 annual
Women Development Banking	1992	Eastern Transvaal	micro	women entrepreneurs	100 - 3,000	6 months	nominal 28 effective 56	n/a

Table 17, cont.

Organization	Collateral/substitutes	Who qualifies for a loan and special requirements	Repayment modalities	Indicators of Quality of Loan portfolio	Observations
ACHIB/First National Bank	track record	12 month of regular savings are required	n/a	n/a	Linkage model between formal and informal sector, new program, first borrower qualified for loan only in Feb.93
Future Bank	n/a	community based	n/a	n/a	Joint venture between FNB and black business organizations FABCOS, current only loans for taxis
Get Ahead Foundation	mutual guarantee	Group loans (stokvel approach)	monthly	90% repayment rate	One of the first programs introducing group lending on a broad scale.
	client reference	individuals	monthly	60% are at risk	The attempt to leverage commercial failed. Loan Program is proposed for close down.
Get-Up! Lending Trust	recommendation from other client	individual and group loans	flexible	default rate 13-16%	Program is run on a small client basis, transaction costs are 75% of loan amount.
Independent Business Enrichment Center	suretyship of community	individuals loans combined with obligatory training	monthly	2% bad debt	One of the younger innovative programs, loans are extended to unemployed people only.
KaNgwane Economic Development	n/a	group lending	n/a	0-10% bad debts,	Typical features of development corporation finance program.
Kwazulu Finance Corporation	not obligatory	individual loans	monthly	30 percent in arrears	Typical development organization running an small business program with traditional elements, if collateral provided lower interest rate is charged.
Lebowa Small Business Dev. Project	n/a	individual	n/a	more than 50% in arrears	Typical development Bank program with all related disadvantages, information confusing.
National Stokvel Association of South Africa (NASASA)	deposit certificate	stokvel groups	monthly	n/a	Tries to connect informal financial mechanisms with commercial banks.
Rural Finance Facility	not explicit	cash deposit of 25% of loan required	flexible	n/a not yet started	Program administers National Union of Mineworkers (NUM) Fund, intends to lend in rural areas with newer innovative approaches.
Small Business Development Corp.	n/a 75% of loan	individual individual	n/a n/a	1/3 write off's n/a	bureaucratic, lacks credibility; provides a broad spectrum of financial services.
Small Enterprise Foundation	group pressure	Grameen Bank type lending / stokvel	bi-weekly	100% recovery rate	Program in expansion phase, innovative approach, savings link, poverty alleviation as objective, women based
Standard Bank	n/a	individual/group	n/a	2.5% in arrears	Standard Banks partner is the Independent Training Trust, graduates are eligible for loans (pilot phase)
Triple Trust Organization	none	individuals must be trainees	monthly, weekly	80% default rate	Loan provision is linked through skills training, small program, recovery problem.
Women Development Banking	none	group lending	monthly	n/a	Affiliated to the worldwide operating network of Women's Development Banking project.

Most of the rural households rely on informal sources. One study found out that 71 percent of credit transactions in Lebowa and 57 percent in KaNgwane are based on informal arrangements for different purposes.⁴⁷ A study in KwaZulu indicates that short term consumer credit by general dealers is the second biggest source of credit, after the Kwazulu Finance Corporation, which is seen as the most efficient one among the homeland development organization.⁴⁸

Due to the lack of formal and semi-formal coverage of rural households, which is estimated to consist of 3 million households or 50 percent of the black population, the informal rural finance sector is characterized by its large size. The role of informal finance in South Africa in terms of loan usage is difficult to assess because of the fungibility of money and the non-targeted approach of informal lenders. Only in recent times has some attention been focused on this question, but data in this sector is meager and does not allow a detailed analysis.

B. Main Programs and their Characteristics

In order to determine the impact of those support organizations, this section will look at the client base and the characteristics of the programs various organizations are offering. Financial contract elements will be highlighted. Unfortunately this can only be done with a selected group of organizations where data are available either through interviews with these organizations or from secondary sources. A distinction between small and microenterprises cannot be strictly applied in all cases.

C. Problems and Constraints: The Supply Side

One can roughly distinguish between suppliers of financial services to small and microenterprises, who provide loans to end borrowers at subsidized interest rates, and those who do not. Drawing from the findings of the studies introduced in table 3, study H points out that 26 percent of the financial institutions charge 10 percent interest per year which is a negative interest rate taking the inflation rate (average annual rate from 1980-1991 was 14 percent) into account. While another quarter charged between 12 and 20 percent. Altogether the majority of respondents provided loans below the prime rate (21 percent in 1991), in other words subsidizing their rates. The third quarter charges between 24-30 percent while the remaining quarter, mainly moneylenders, were charging between 36-90 percent interest.⁴⁹

⁴⁷ Gerhard K. Coetzee "Die Finansiering Van Landbouproduksie in die Kleinboersektor van Suid-Afrika (Master Thesis, Universiteit van Stellenbosch, 1988), p. 77.

⁴⁸ Catherine Cross, "Informal Credit--or, How does a Rural Community capitalize itself?" (Durban, University of Natal, 1986), p. 3.

⁴⁹ Ros Hirschowitz et al., "Financiers and their Views on Informal Businesses," pp. 223-224.

The lack of knowledge regarding international experience with the provision of financial services to small and microenterprises is one reason why the majority of the organizations are still sticking to the policy of subsidized interest rates with counterproductive effects such as credit rationing and adverse selection. Loans are targeted and the efficiency of the financial system to channel scarce resources toward the most profitable investment is distorted.⁵⁰ The Development Finance Corporation and other government or parastatal institutions are still acting according to policies which failed in most other countries. Also in South Africa, data suggest that small and microenterprises are seeking access to appropriate financial products tailored to their needs more urgently than cheap credit. Interest rates are only one component in the design of a financial product making it attractive to borrowers. Flexibility, collateral, and transaction costs faced by a potential borrower are other important elements of loan contracts. Only 2.2 percent of borrowers demanded cheap loans. In addition 98 percent do not see any repayment problem.⁵¹

Most of the more recently established NGO's and those now in an implementation stage took advantage of international experience to formulate lending criteria. Most of them intend to lend at interest rates that cover costs. Up to now none of them can be seen as financially self-sustainable, but the interest rate charged is calculated so that after the start-up or expansion phase, the financial viability of the institution can be achieved. Positive examples are the Small Enterprise Foundation, Rural Finance Facility, and World Women's Banking. The Get Ahead Foundation is aware of the problem, but as the longest operating NGO in micro lending, it was not able to reach its target.⁵²

Whether those organizations will succeed in their ambitious goals cannot be predicted at this stage. Experience from the Grameen Bank in Bangladesh shows that financial viability and, therefore, institutional sustainability is hard to attain. The Subsidy Dependence Index (SDI) developed by Jacob Yaron⁵³ as an indicator of institutional viability without outside support, suggests that despite the marvelous performance of the Grameen Bank, without subsidies it would not be viable. Whether the SDI is an appropriate instrument for evaluating an institution like the Grameen Bank is internationally discussed contrary and cannot be answered here.

High transaction costs and the lack of knowledge to minimize them through mechanisms like linkages among financial intermediaries are reasons for commercial banks to exclude small and microenterprises from their clientele. In all interviews conducted with commercial banks it seems

⁵⁰ See Ohio State University Literature list for background information.

⁵¹ U.S.AID/South Africa, Survey of Black Enterprises and their Attitudes towards NAFCOC, Vol. III, (Johannesburg, Consumer Behaviour Pty. Ltd., 1987), p. 222.

⁵² GEMINI, "Final Evaluation of the Get Ahead Foundation," 1992.

⁵³ Jacob Yaron, "Successful Rural Financial Institutions," World Bank Discussion Paper No. 150 (Washington, World Bank, 1992).

that the lack of knowledge to access those clients on a cost covering basis was the main concern rather than the reluctance to continue with racial discrimination in a new South Africa.

One case is known where Standard Bank in cooperation with the Get Ahead Foundation tried to develop a link among operations to leverage bank funds and connect clients to formal financial institutions. This pilot project is said to have failed mainly because of the unequal risk sharing among both institutions in which the formal bank failed to monitor and took the lowest risk and earned the higher spread.⁵⁴ Contractual arrangements and mechanisms to link formal financial institutions via intermediaries (NGO, Self-help Groups etc.) might be worth exploring in the future.⁵⁵ The Small Enterprise Foundation, for example, has achieved an intermediate position which might be cost effective in the future by serving as a link between end borrowers and commercial banks. All monetary transactions are done between the bank and the borrower directly; the Foundation only facilitates financial intermediation.

Through the broad network of commercial banks established countrywide, the conditions for connecting clients with the country's financial system seems favorable, especially in comparison to other African countries where markets are extremely segmented due to a lack of institutional infrastructure. In this regard the community banking project should be mentioned. Its goal is to set up a formal network of community banks serving the previously excluded segments of the population through a broad range of financial products. The profit making bank will have deposit facilities, commercial loans, consumer loans, etc., and will follow the spirit of the "German Sparkassen or Raiffeisen and Genossenschaftsbanken."⁵⁶ Up until September the negotiations about implementation were at a final stage. If it is determined to be a viable institution, it could well play an important role as supplier of financial services to micro and small enterprises.

The design of financial products seems to be one of the major obstacles in providing loans to the clientele in question. Taking into account the more than 400,000 potential clients (homeland areas excluded), and the client base of above mentioned institutions (roughly about 20,000 to 30,000), it can be concluded that the coverage of existing programs is narrow and has the potential to increase. Those programs imitating the characteristics of informal loan contracts operate more

⁵⁴ Ibid, p. 13.

⁵⁵ One of the successful examples of linkages among financial intermediaries is the BRI Unit Desa System in Indonesia. See James Boomgard and Kenneth J. Angell, "Developing Financial Services for Microenterprises: An Evaluation of USAID Assistance to the BRI Unit Desa System in Indonesia," GEMINI Technical Report No. 6 (Maryland, GEMINI, 1990).

⁵⁶ An detailed evaluation of the proposed project can be found in: Community Banking Project, "Report on an appropriate Basis for and the Feasibility of Community Banking in South Africa," (Johannesburg 1992).

successfully and have a broader reach of clients.⁵⁷ The Small Enterprise Foundation, for example, offers loans based on stokvel mechanisms as well as several other 'better performers'. The Foundation reports that the demand for their product is extremely high and they cannot handle all the loans demanded due to capacity problems and because they are trying not to expand too rapidly in order to maintain strict monitoring and, therefore, an excellent loan portfolio. This was one of the handicaps the Get Ahead Foundation could not handle properly. It was one of the first NGOs to operate on a broader scale with stokvel mechanisms. Due to local and international desire for a suitable and promising candidate to service the oppressed group, an overly rapid expansion is thought to be the reason for problems reflected in the quality of its loan portfolio.⁵⁸

The most common similarity among all these programs in their attempt to provide financial services to micro and small enterprises is the unsustainability of the institutions themselves. Most are not viable in the long term without outside support such as subsidized refinance possibilities offered by the DBSA, donor monies, or direct government funds. This leads not only to dependency but also to political intrusion. In the worst case scenarios, outside funding dries up, and these institutions are forced to close down their operations; the endborrower is hurt the most. An institution is valued by clients not because of cheap loans, but because of the types of services offered, the reliability of the institution, and the durability of services.⁵⁹

Programs implemented by the development corporations are hardly viable, as the small enterprise program in Lebowa suggests.⁶⁰ The Get Ahead Foundation can cover only 33 percent of costs⁶¹ of its stokvel program. Without the massive outside support from international donors, the organization would have been forced to look for measures which would reduce transaction costs on the borrower or lender side. But due to access to 'easy' money such innovations hardly take place.

This seems to be one reason why the formal financial system is unable to provide services to those clients who pay up to 90 percent interest to informal lenders without defaulting. Limited

⁵⁷ Dale W Adams and Delbert A. Fichett (eds.), Informal Finance in Low-Income Countries (Boulder, Westview Press, 1992); and Robert Peck Christen, What Microenterprise Credit Programs can learn from the Moneylenders, Discussion Paper Series, Document No.4, (Cambridge, ACCION International, 1989); Sagrario L. Floro and Pan A. Yotopoulos, Informal Credit Markets and the New Institutional Economics (Boulder, Colorado, Westview Press).

⁵⁸ GEMINI, "Evaluation of the Get Ahead Foundation," p. 8.

⁵⁹ Claudio Gonzalez-Vega, "From Policies, to Technologies, to Organizations: The Evolution of the Ohio State University Vision of Rural Financial Markets," Paper presented at the Conference FINANCE 2000, Washington May 27-28, 1993, p. 24.

⁶⁰ J. Sender and A. Feinstein, "An Evaluation of the Small Business Development Programme in Lebowa," unpublished, (Johannesburg, University of Witwatersrand, 1991).

⁶¹ GEMINI, "Evaluation of the Get Ahead Foundation," p. 37.

competition in South Africa's formal banking sector does not force banks to be innovative and develop products serving client credit needs. Government initiated programs often artificially hinder those innovations and undermine small and microenterprise development through the provision of directly targeted and subsidized loans.⁶²

The majority of existing financial programs were introduced to generate economic growth in the small and microenterprise sector because it was regarded as crucial for national development to overcome the injustices of apartheid. Programs are seen as subsector programs rather than finance programs which will release the sector under consideration from the assumed major obstacle of lack of access to credit. Most programs do not recognize that "the causal links between receipt of credit by individual borrowers and their subsequent economic growth are indirect, credit being but one factor in an extremely complex process of decision making by enterprises and households. Financial services are valued more for their general enabling effects across whole economic sectors, rather than for direct change induced by individuals. Whereas this view, the financial system approach, is more and more accepted as correct, programs continue to believe in a direct line of causality between receipt of credit by individual borrowers and a particular desired economic response, for example changed borrower income resulting directly from receipt of a particular loan."⁶³ These views began only recently to influence the discussion about support to small and microenterprises through financial services in South Africa. A minority of organizations are aware of the problem, know about the importance of institutional viability, and design their services accordingly.⁶⁴

One point of concern mentioned by a better performing NGO was the support for institutional development by subsidizing the institution rather than the end borrower. How far should institutional support should go before it becomes self-defeating? This should be a part of the current discussion, for example, in the DBSA which is a wholesaler of finance to development institutions. Some NGOs fear that without regulations for pure commercial versus soft loans the better performers will be disadvantaged or in the worst case scenario even destroyed by subsidized competitors. This particular NGO saw cheap funds as a deterrent for institutions trying to be financially self sustainable by not being 'protected' against competition from subsidized loan programs.

A majority of support organizations regard lack of training, finance, and technical support as the main obstacles of small and microenterprise development. Instead of specializing in one of the above areas and looking for other competent partner organizations in the other fields, they tend

⁶² Dale Adams et al. (ed.), Undermining Rural Development with Cheap Credit, (Boulder, Colorado, Westview Press, 1984).

⁶³ Elisabeth Rhyne, "A New View of Finance Program Evaluation," GEMINI Working Paper No. 32, (Maryland, GEMINI, 1992), p. 2.

⁶⁴ For theoretical background see for example Sagario L. Floro and Pan A. Yotopoulos, Informal Credit Markets and the New Institutional Economics, (Colorado, Boulder).

to provide all services on their own. The conflict of interest, which lies in the nature of providing training and finance together on a viable basis with strict repayment and enforcement mechanisms necessary for a successful loan program, predicts a certain degree of inefficiency. How can one collect loans rigorously when the borrower was trained or advised by the same institution? This implies a contradiction of operations right from the beginning of each program. Indeed international experience suggests that dealing with one bottleneck has a far greater chance of achieving the desired results in promoting small and microenterprise development. Whether it can be assumed that one can identify correctly that key bottleneck cannot be discussed here.

V. Conclusions

The black small and microenterprise sector is extremely restricted by the policies of apartheid and the long term damage which a new South Africa has to overcome. Apartheid legislation like establishment of black businesses, black skilled employment, black educational opportunities, and the spatial arrangements of South African cities, which separated blacks and their businesses from the white urban areas where markets and purchasing power are concentrated, limits the potential of this sector to make a significant contribution in the country's development in the short run. In addition the current adverse economic situation offers few incentives to enter and expand this sector. An economic recovery seems to be the most important necessity in order to empower this sector and provide it with investment opportunities. Under current circumstances the environment is adverse to entrepreneurial activities. Unfortunately both the legacy of apartheid and the economic situation can be solved only in the medium to long term, building the foundation for any significant contribution of small and microenterprises to South Africa's development. Traditional tools and programs like training, technical support, and finance to promote those enterprises cannot have a strong impact until the other issues are addressed, which can be accomplished only with more encompassing policy implementation. South African entrepreneurs regard the current economic situation as their major obstacle, not the traditional services offered worldwide by development organizations. This can change substantially when the economic hardship starts to improve. It can be expected that the demand for services will increase.

Out of the traditional bottlenecks, the lack of access to finance is felt by the entrepreneurs as the most important one. In relative terms, however, it is soberingly low and should not be overestimated. These traditional support mechanisms are currently overshadowed by the economic situation and will probably become more significant obstacles in the future. Therefore it is now time to create an enabling environment where market forces can establish an institutional support network. Even if South Africa has numerous support organizations, their coverage is low. Only about ten thousand out of half a million enterprises are reached. The regional coverage is segmented and tends to be concentrated mainly in urban areas. The majority of those organizations provide services which are outdated in terms of international lessons learned from small and microenterprise development strategies elsewhere. Some of the providers of financial services show encouraging

initiatives by following policies which promise a more successful performance, but their influence is still marginal.⁶⁵

One has the impression that the current institutions need to be strengthened to support small and microenterprises. Dissemination of information on how to reach the clients efficiently seems to be an urgent need. The shift from programs to markets is not yet recognized.⁶⁶ International experience indicates that the provision of financial services to marginal clients is more likely to succeed if it is dealt with by a financial systems approach.⁶⁷ In addition to this view consciousness about the importance of financial sustainability, institutional viability, incentives, etc., known as the "new theoretical institutionalism" should be taken into account. One component of this approach, the economics of information, becomes more and more relevant not only for small and microenterprise finance but for financial system development per se.⁶⁸

Strongly related to the financial viability of these institutions is the forgotten half of finance: the savings component. The importance of role of savings with its enabling role for development is not yet recognized by operating institutions. Saving product design, if included at all, is inappropriate to serve the people. Simultaneously legislative questions arise.

The promotion of linkages among the formal banking sector and semiformal and informal institutions should be promoted as well as research in the area of informal financial services to learn from their mechanisms for creation of appropriate financial products. Institution building is required in South Africa for support organizations in order to satisfy the need for the small and microenterprise sector in a durable way.

An extremely small data base restricts sound conclusions about the sector nationwide and the elaboration of country-specific tools to efficiently promote those businesses. As pointed out in several passages of the paper, the current deficiency of reliable quantitative and qualitative data does not allow comparisons and sound conclusions. Therefore it is argued for more research in that field. The lack of data makes it impossible to address the problem and potential of rural enterprises

⁶⁵ A comprehensive summary of the lessons learned from recent research in the area of microenterprise finance can be found in: Otero, Maria and Elisabeth Rhyne (eds.), The New World of Microenterprise Finance. Building Healthy Financial Institutions for the Poor, (West Hartford, Kumarian Press, 1994).

⁶⁶ Richard L. Meyer, "Financial Services for Microenterprises: Programs or Markets?" Jacob Levitsky (ed.), Microenterprises in Developing Countries, (London, Intermediate Technology Publications, 1989), pp. 121.

⁶⁷ Elisabeth Rhyne, Financial Services for Microenterprises: Principles and Institutions, World Development, Vol. 20, (Great Britain, Pergamon Press, 1992), pp. 1561-1571.

⁶⁸ For the different views of Finance and Development see: Krahnen, Jan Pieter and Reinhard H. Schmidt, "Development Finance as Institution Building," Draft, March 1992, pp. 10-31.

specifically. The small data base on rural enterprises does not allow generalizations. But it suggests that rural enterprises face similar types of constraints as urban enterprises whereas the adverse economic situation hits rural enterprise even harder. A particular information deficit exists about small and microenterprises in the homeland areas. Their most probable reintegration into South Africa poses additional challenges for support organizations.

To enable semi-formal and informal financial market participants to intermediate efficiently between the formal system and themselves, restrictive financial regulations need to be revised. The Usury Act which restricted financial institutions from deposit taking was amended in 1990 shifting non-bank institutions toward a more functional, extended role. As important as a saving-credit link is for marginal clients facilitating financial intermediation, this can be regarded as a step forward.⁶⁹ On the other hand principles of regulation and prudential supervision of savings taking semi-formal financial intermediaries have been not yet addressed. Still in power is an interest rate ceiling of 32 percent which led some semi-formal market participants to operate illegally and forced formal institutions to ration credit. The informal intermediaries fall under South Africa's general financial legislation (e.g. Usury Act) and currently discussion is under way to restrict this segment of the market to protect investors. Besides difficult enforcement and high monitoring costs this would restrict those intermediaries in their flexibility. They are valued by their clients, who prefer them to formal institutions, which do not permit access to certain groups. Financial legislation should promote the leverage between formal, semi-formal, and informal institutions. Encouraging beginnings have been made in the linking of commercial banks and NGO's which should be broadened.

The policies biased towards urban and big enterprises should be removed. This would help small and microenterprises more than market distorting support programs. To answer distortions by distortions leads only to third best policies which hardly serves the overall country development. It should be pointed out that efficient and viable financial programs for small and microenterprises are more likely to succeed if created as an integral part of the financial system. Unfortunately this approach as well as specialized programs are unable and inefficient in dealing with the urgently needed redistribution of wealth in South Africa. But it is efficient in terms of optimal resource allocation. Therefore it is argued that subsidization if considered as a political imperative should rather go directly in the form of lump sum transfers to entrepreneurs instead via market distorting special programs which might impose high transaction costs.

As with many private sector development projects, recent research and evaluation reports point to the critical importance of favorable economic and policy environments for project success. Under current unfavorable conditions, programs have an extremely limited effect. Employment creating projects are stressed to work best in fast-growing economies free of policy distortions. "Trying to offset [massive price distortion resulting from misguided industrial policy] with targeted

⁶⁹ I. Goodspeed et al.(ed.), The Regulation of Financial Markets: Essays on the South African financial Markets (Johannesburg, Southern Book Publisher, 1991), pp. 24-25.

intervention that favor small firms is at best fiddling while Rome burns".⁷⁰ Previously project designers treated external constraints as beyond their direct control. Greater attention should be given to policy reform initiatives in such areas as interest rate ceilings, foreign exchange controls, and trade policy, which have particular relevance to small enterprise projects.⁷¹ To date, these issues are not fully addressed in South Africa.

⁷⁰ Cressida McKean and Annette Binnendijk, "A.I.D.'s Small-Enterprise and Microenterprise Projects: Background and Current Issues," A.I.D. Occasional Paper No. 18, (Washington, U.S.AID, 1989), p. 17.

⁷¹ Ibid.

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